

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

The City of Pekin, a Municipal  
Corporation

Petition for Approval Pursuant to  
735 ILCS 5/7-102 to Condemn a  
Certain Portion of the Waterworks  
System of Illinois-American Water  
Company

Docket No. 02-0352

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**EXCEPTIONS OF PETITIONER CITY OF PEKIN**

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## **EXCEPTION ONE: PEKIN'S POSITION**

Petitioner City of Pekin takes exception to the portions of pages 5 to 7 of the Proposed Order that are entitled "Pekin's Position." Pekin suggests the "Pekin's Position" at pages 5 to 7 of the Proposed Order be deleted in its entirety and replaced by the following language for the reasons set forth in its Brief on Exceptions:

### **A. Pekin's Position:**

#### **1. Legal Standard**

The City's Petition to acquire the Pekin Water District (Pekin District) from Illinois American Water Corporation (IAWC) was filed under Code of Civil Procedure § 7-102, which the City notes does not contain a "public interest" or "public convenience" requirement. The City indicates that Staff pointed out that the Commission's role under that statute is to ensure "that property necessary for utility purposes is not taken." See Department of Conservation v. Chicago & North Western Transportation Co., 59 Ill. App. 3d 89, 91 (1978). Accordingly, the City submits that its Petition should not be evaluated "as a competing alternative" that must serve the public interest "better" than IAWC's continued ownership. However, the City notes that it has argued that its Petition should be approved even if the Commission adopts the more stringent public interest standard.

#### **2. City acquisition is in the public interest**

##### **a. City acquisition has citizen support**

##### **(i) Endorsed by voters**

The City highlights that, despite IAWC spending approximately \$1.5 million on advertising campaigns against the last two referendums, the most recent advisory referendum found 61% of the City voters in favor of City acquisition. [Pekin Ex. 1.0, p. 8; Tr., pp. 740-741.] The City maintains that the voters have voiced their desire and their view of what is in the public interest – the acquisition of the Pekin District.

The City dismisses IAWC's challenges to the reliability of the referendum results. The City contends that, in an attempt to support its allegations, IAWC cites to a single response from a single voter in a survey sponsored by IAWC – a survey for which no background information regarding methodology, impartiality, response rate or total results was ever disclosed. [IAWC Ex. 5.0, pp. 14-15.] The City also points out that even the lone "confused" voter quoted by IAWC indicates both he and his wife successfully recorded their desired votes. [Id.] The City maintains there is no support for IAWC's challenges to the referendum's result. The City also emphasizes that Staff recognized the citizen support demonstrated by the recent referendum to be an advantage of City acquisition. [Staff Ex. 1.0, p. 17.]

**(ii) Recommended by citizen task force**

In 1998, the City created a Water Study Task Force Committee (“Water Task Force”) to study the potential benefits and detriments that would result from the City’s acquisition of the Pekin District. [Id., p. 4; Pekin Ex. 1.1, p. 1.] The Water Task Force was comprised of a variety of unbiased citizens who live within the Pekin District’s service area, including areas outside the City limits but within the territory serviced by IAWC through the Pekin District. [Pekin Ex. 1.0, pp. 4-5.] The City further submits the Water Task Force consisted of high quality individuals with a great deal of business expertise. [Id.; Pekin Ex. 1.1, p. 1.]

According to the City, the Water Task Force studied all aspects of City acquisition – gathering information from many sources, including IAWC. The City explains that the analysis of the Water Task Force included the review and analyses of IAWC’s responses to 42 questions. [Id., Tab 10.] These questions included inquiries regarding rates, profits, overhead, customer service, capital and strategic planning, and other aspects of IAWC’s ownership and operation of the Pekin District. [Id.]

At the conclusion of its study, the Water Task Force prepared a 65-page report supporting its unanimous recommendation to the City Council to move forward with the acquisition of the Pekin District. [Id., p. 2; Pekin Ex. 1.0, p. 6.] The Water Task Force based its recommendation on issues of City control of its natural resources and rates for water, finding: City ownership will “significantly reduce future rate increases”; “keep significant cash flow and profit dollars in the City”; “allow the integrated planning of infrastructure (roads, sewer, water) maintenance”; “provide additional means to help manage future City growth”; and might also “provide additional jobs” in the City. [Id.; Pekin Ex. 1.1, Letter of Recommendation.]

The City further points out that two different City Councils, the elected representatives of the people, have unanimously voted to exercise the powers and authority given them by the Illinois legislature to condemn the waterworks.

**b. City acquisition will result in an expeditious resolution of current fire protection and public safety concerns**

According to the City, in recent eminent domain proceedings this Commission has considered public safety an important determination in ascertaining the “public interest.” See, e.g., Department of Transportation v. Union Pacific Railroad Co., Sept. 25, 2002 Order, Case No. T02-0044, 2002 WL 31477179 (ICC 2002) (granting easements for construction of an overpass over railroad tracks to enhance the public safety and convenience); Department of Transportation v. Illinois Central Railroad Co., Jan. 24, 2002 Order, Case No. T01-0060, 2002 WL 1156035 (ICC 2002) (granting right-of-way for improvement of state route for purpose of improving public safety). The City asserts that acquisition will place control of these public safety issues squarely in the hands of the City and its elected officials.

**(i) Small diameter mains**

Portions of the Pekin District date back to 1886. [Tr., p. 894.] The City has advised IAWC and IAWC's Vice President of Engineering has acknowledged that many of the distribution mains throughout the system are too small to provide sufficient fire flow capacity. [Pekin Am. Ex. 2.0, p. 3; Pekin Ex. 1.0, p. 13; Tr. pp. 946-947.] The City notes that, as recently as last year, the City's fire department was unable to stop a local business, Jim's Automotive, from burning to the ground. [Id., p. 431; Pekin Am. Ex. 3.0, p. 4.] The City's Fire Chief testified that because of the old water mains, the fire department was unable to supply its vehicles with enough water to even make headway against that fire. [Id.] The City's Fire Chief also testified the loss of the Jim's Automotive building was "directly a result of the inadequate size of these old water mains." [Id.]

The City's Fire Chief also testified that a building was lost because of insufficient fire flow in two Anderson Upholstery fires. [Tr., pp. 429-430; Pekin Am. Ex. 3.0, p. 5.] He testified that, despite the fire occurring over 16 years ago, the problem mains have not been fixed. [Id.]

IAWC acknowledges that it has taken 21 years to reduce the small mains by only 11%. As argued by the City, with 89% of the problem mains remaining, at a replacement pace of 11% every 21 years, it would take exactly 169.9 years to complete the small main replacement.

The City contends that IAWC's 30-year statewide small main replacement program does not adequately resolve this important issue of City control. IAWC acknowledged that its statewide strategic plan for small main replacement is subject to IAWC's ever-changing financial conditions. [Id., p. 956.] The City points out that IAWC's main replacement program is subject to IAWC's statewide capital plan, which necessarily requires adjustment after any new acquisition or merger. [Id., pp. 929-931.] IAWC's capital improvement planning is neither reviewed by the Commission nor subject to Commission approval. [Id., pp. 933-934]. As such, the City contends that if a decision is made by IAWC to alter, defer or cancel a planned capital improvement, such as the small main replacement program, neither the City nor the Commission will have input or review of that decision. [Id., pp. 934-935.] City acquisition of the Pekin District will place control of these issues squarely in the hands of Pekin.

As a further example of the need for City control, the City notes that IAWC's Vice President of Engineering testified that IAWC identified low pressure and fire flow problems in the Sunset Hills section of the City in 1990. [Tr., p. 944.] Despite being identified as a problem 13 years ago, and despite being reclassified by IAWC as a "higher priority" in 1996, the City notes that the necessary booster pump station has not been installed, and the fire flow problems in that section of the City remain uncorrected. [Id., p. 944-946.] IAWC's proposed small main replacement plan is "subject, like the

Sunset Hills booster project, to the ever-changing conditions for Illinois-American.” [Id., p. 956.]

The City testified that upon acquisition it plans to “aggressively replace the inadequate mains, so that all areas of the City are served with acceptable pressures in the event of fire.” [Pekin Ex. 1.0, p. 13; Tr. p. 436.] Testimony from the Staff in this proceeding specifically recognized that a capital improvement program tailored more toward main replacement and safety is one advantage of City acquisition. [Id., pp. 91-92.]

The City established in testimony that its adjustments to water main replacement can be made with only local interests and municipal and fire department priorities in mind. [Pekin Am Ex. 7.0, p. 11; Pekin Ex. 1.0, p. 13.] According to the City, local municipal ownership will also allow the City to tap into a variety of funding sources that are unavailable to private enterprises like IAWC. [Id., p. 18.] The City maintains that this flexibility and availability of funding resources will allow the City to address the fire concerns posed by the small water mains in the most expedient manner, enhancing the public safety.

The City asserts that its ability to fund an accelerated main replacement program is concisely proven by a comparison of IAWC’s actual capital improvement expenditures for the years 2003-2012 with Ms. Hals’ feasibility analysis that maintains the five-year rate freeze. The capital improvement numbers shown in Ms. Hals’ original Schedule A-2 were an estimate of what Ms. Hals determined are necessary capital improvement expenditures for the Pekin District given RFC’s extensive experience in the water industry – approximately \$20 million for the ten-year period from 2003-2012. IAWC’s actual capital improvement plans for the years 2003-2012 total only \$11.2 million. As such, the City submits that City acquisition results in the five-year rate freeze while spending over \$8.8 million more than projected by IAWC for its capital improvement expenditures in the same timeframe. [Pekin Ex. 8.0, pp. 16-19, Ex. 8.2]

The City highlights that, based on IAWC’s own numbers, the \$8.8 million in additional capital improvement expenditures would have a dramatic impact on small main replacement. The City notes that IAWC projected that it could replace 5,000 feet of mains annually at a cost of \$300,000 per year. With the \$8.8 million in additional capital expenditures during the first ten years of City acquisition, the City concludes that it could replace over 145,000 additional feet of mains, while maintaining all other capital improvements planned by IAWC.

## **(ii) Gravel in the water mains**

The City asserts that the record in this proceeding also demonstrates historical and ongoing problems with gravel in the water mains. [Tr., p. 432; Pekin Am. Ex. 3.0, p. 5.] The City notes that while IAWC contends no evidence of this gravel problem actually exists, IAWC’s own witness, Randy West, testified that he was aware of gravel in a hydrant. [Tr., p. 991.] The City’s Fire Chief explained that this gravel could destroy

the fire department's fire pumps and valves if the fire department does not continually take the precautionary step of flowing the hydrant water before allowing it into the City's fire equipment. [Pekin Am. Ex. 3.0, p. 5.] The City contends that this problem would be improved through the increased accountability and local control that would be available through City ownership of the system. [Tr., pp. 432-433.] This contention is supported by testimony from the City's Fire Chief:

The City Manager and the City Council are directly responsible and accountable to its citizens. As the Fire Chief, given the risk posed by the prior inaction, I would be pressing hard to have the most serious deficiencies in the system addressed as soon as possible. We need people who are accountable to the citizens to be making the decisions with respect to these areas.

[Pekin Am. Ex. 3.0, p. 6.]

**c. The City can acquire and operate the system, implement the necessary capital improvements and maintain fair rates**

As part of the City's investigation of whether it should attempt to acquire the Pekin District, Rafetelis Financial Consulting, PA (RFC) prepared a financial feasibility analysis. RFC concluded it is financially feasible for the City to acquire and operate the Pekin District, make capital improvements proposed by IAWC, and have a revenue surplus from the Pekin District to fund a more expeditious replacement of the system's small mains.

**(i) Ms. Hals and RFC are qualified professionals**

The City asserts that the experience and expertise of Ms. Hals and RFC cannot be discredited. The City notes that Ms. Hals has a Masters of Business Administration in Finance and, as demonstrated by her curriculum vitae, experience in a broad variety of financial valuation, economic impact, and feasibility projects involving public utilities and, more specifically, water utilities. [Pekin Ex. 5.1.]

The City also notes that Ms. Hals had the benefit of the resources and expertise of RFC, which testimony demonstrates is a highly experienced and reputable management and financial consulting firm in the water industry. The City highlights RFC's extensive experience in water utility valuation, acquisition feasibility analysis, financial planning, and rate development and implementation. [Pekin Ex. 5.0, p. 2.] Specifically, the City shows that RFC has conducted at least 18 water utility valuations for communities throughout the United States, including several analyses that involved subsidiaries of AWWC. [*Id.*, pp. 2-4.] The City further notes that "[a]s a part of the valuation analysis, the majority of these engagements included financial feasibility analyses to estimate customer rate impact and long-term economic impacts associated with communities purchasing the water system that serves its constituents." [*Id.*, p. 3.] In addition, the City points to the fact that "RFC has performed approximately 300



related financial, economic, and pricing studies, which have elements that are similar to valuation analysis concepts.” [Id., p. 3.]

The City explains that IAWC attempts to attack Ms. Hals’ credibility by implying that her valuation analysis fails to conform with the American Society of Appraisers (“ASA”) Appraisal Standards. However, the City asserts that IAWC’s valuation expert had the opportunity to challenge Ms. Hals relative to the ASA standards, but never cited any specific standard promulgated by ASA, or any other authoritative body, to demonstrate how Ms. Hals failed to meet that standard. The City further contends that, even with respect to IAWC’s biggest criticism – Ms. Hals’ exclusion of RCNLD – IAWC was unable to point to any source to prove that Ms. Hals’ methodology in this regard was flawed. The City believes that the record supports the credibility and qualifications of Ms. Hals and RFC.

## **(ii) Savings available only to municipally owned utilities**

The record is clear, including support from IAWC’s valuation expert, that publicly owned utilities have cost savings that are not available to privately-owned utilities. This is because municipal owners can issue bonds resulting in lower capital costs, can access state and federal loan programs at very favorable rates, do not need to provide a return on investment to shareholders, and are not required to pay income or property taxes. [Pekin Ex. 1.0, pp. 18-19, Pekin Ex. 5.0, p. 8, IAWC Ex. 10R, p. 14.] The City also emphasizes that Staff identified these facts as benefits of City ownership of the system. [Tr., pp. 72-73; Staff Ex. 1.0, p. 6.] To emphasize the significance of these savings, the City points out that Ms. Hals testified “IAWC projected a tax rate of 25.6% for base year 2001 in its 2000 rate case, which translates into approximately 8% of total revenue requirements.” [Pekin Ex. 5.0, p. 8.] Further, the City notes that IAWC’s projected income taxes for 2003 are \$563,000 and go up to \$680,000 in 2012. [Pekin Ex. 17.1, p. IAWC 02446.] These costs would not exist under City ownership.

The City highlights that IAWC’s own witness recognized the City’s access to funding sources unavailable to IAWC. [Tr., p. 983 (acknowledging a grant received by the City but not available to IAWC).] The City contends economic savings are also possible because of IAWC’s high cost of common equity of 11.015%, which makes up more than 45% of its capital structure. [Pekin Ex. 8.0, p. 24.] According to the City, IAWC’s rate of return on equity is significantly higher than the City’s cost of debt. [Pekin Ex. 17.0, p. 24.] These savings are not available without City ownership.

The City emphasizes that the variety of funding sources, combined with no required return on investment, results in publicly owned utilities having an overall lower cost of capital than that of privately owned water utilities. City witness Hals summarized this benefit as follows:

The municipal cost of capital is lower than that of privately owned water utilities. Therefore, municipalities are able to finance capital improvements with a lower cost of capital than the rate of return typically required by investors of

privately owned water companies. For example, IAWC's weighted average cost of capital, or allowed return on rate base, as approved in its 2000 rate case was 8.4%; however, the City of Pekin can issue debt at a rate of 4.42%.

[Pekin Ex. 5.0, p. 8 (footnote omitted).] Furthermore, while IAWC points to available tax-exempt debt available to IAWC, the City highlights that this tax-exempt debt only makes up 16.1% of Illinois-American's overall capital structure, whereas the City would have access to this type of funding for 100% of their capital improvements. [Pekin Ex. 8.0, p. 24.]

The City maintains that these savings, all of which were highlighted in RFC's financial feasibility analysis, illuminate the financial benefits of City acquisition and illustrate that the public interest will be served.

**(iii) A rate freeze, as well as a reduction in future rate increases**

The City explains that the savings available to municipally owned utilities allow those utilities to charge less for their services. For example, the City points to RFC's analysis, which illustrates that the current end-user rates under IAWC's private ownership are 19% higher than the average rates of neighboring water systems, most of which are publicly owned. [Pekin Ex. 5.0, pp. 15-16.] The City also notes that this finding was further supported by the City Manager's rate comparison with several other cities, which concludes "the Pekin rate is at or near the top." [Pekin Ex. 1.0, p. 21.]

The resolution to acquire the Pekin District passed by the City Council included a five-year rate freeze for all customers of the Pekin District. [Tr., p. 209.] The City maintains that the feasibility of this rate freeze, as well as lower rate increases and customer bills in the future under municipal rather than private ownership, was demonstrated in the financial feasibility analysis prepared by RFC. [Pekin Ex. 5.0, pp. 13-14.] As summarized by City witness Hals, "Although RFC's analysis projects no rate increases for six years, the City of Pekin has indicated a rate moratorium for five years. This will allow the City flexibility in its financing plan and the potential to perform additional capital improvements as needed." [Id., p.13.]

The City also notes that, as demonstrated in RFC's feasibility analysis, the City is projected to pay off the initial purchase of the system in 2024. [Id., p. 13.] At that time, the City contends there would be additional revenues available for additional capital improvements or another freeze in rates. [Id.]

Based on record evidence, the City maintains that this rate freeze can, and will, be accomplished while operating the system on a self-sustaining basis. [Id., pp. 13-14; Pekin Ex. 17.0, pp. 21-22.] According to the City, "RFC's feasibility analysis is and has always been clear on this issue. There are no grants or City reserves in [RFC's] analysis used for supporting rates or finances of the water system... RFC's feasibility

analysis is self-supporting.” [Id., p. 21.] The self-sustaining nature of the Pekin District is further supported in the testimony of Ms. Hals:

Much of Ms. Kane’s analysis hinges on the use of and the ability of the General Fund to support the water system... RFC has worked extensively in municipal financing similar to that anticipated by the City. RFC’s analysis demonstrates that the water system can be operated on a stand-alone basis and would not need to be supported by the General Fund.

[Pekin Ex. 8.0, p. 21.]

The record demonstrates that the rate freeze would not require the City to defer capital and maintenance spending. Ms. Hals specifically addressed this issue: “As demonstrated in RFC’s original testimony and alternate analysis, the rate freeze discussed by the City will not be at the deferral of spending for maintenance and capital improvements, but because current rates would generate revenues over and above revenue requirements under City ownership.” [Id., p. 22.]

The City explains that RFC performed an alternate income approach analysis based on IAWC’s criticisms, and even that analysis demonstrated substantial savings. The City notes that RFC’s alternate income analysis used the capital improvement data and the weighted average cost of capital information provided by IAWC’s witnesses. [Id., p. 16.] According to the City, this alternate analysis reflected greater savings, demonstrating the City would not be required to raise rates over the current levels until 2016. [Id., pp. 17-18.] The City concludes that this alternate analysis demonstrates the City’s pledge of a five-year rate freeze is conservative by nine years. The City maintains that, because the City has indicated a rate freeze for only five years, RFC’s alternate analysis illustrates even greater flexibility in the City’s financing plan and the potential to perform expedited capital improvements.

The City argued that its operation and management costs would remain the same as IAWC’s, but considered this assumption to be conservative. According to the City, reductions in operating costs are more likely. First, the City contends that it would not have to support the large overhead costs of the American system or costs associated with regulation. [Id., p. 19.] Second, the City points to the variety of sources from which the City can obtain the advantages of mass purchasing. Specifically, the City notes that the City Manager testified, “As a governmental entity, we are entitled to national and state contracts for nearly every commodity we use. These contracts offer very large discounts. Additionally, we would have available to us the buying power of our contract operator.” [Pekin Am. Ex. 7.0, p. 7.] Third, the City asserts that its competitive bid process for a contractor operator would create an incentive for cost reduction that could result in a 10% reduction in operating costs. [Pekin Ex. 5.0, p. 15; Pekin Ex. 8.0, p. 19.]

As explained by the City, RFC's alternate analysis still demonstrates significant financial benefits to the rate payers (i.e., a rate freeze for four years), even assuming IAWC's worst case scenario regarding operation and management costs. [Pekin Ex. 17.0, p. 20.] City witness Hals summarized that if RFC agreed with all alternate assumptions offered by IAWC experts to the RFC income analysis except for the purchase price of the system, the acquisition of the system is economically advantageous to the customers of the system because rates over time would be significantly lower under municipal ownership than under IAWC ownership. [Id.]

IAWC's witness, Mr. Ruckman, admitted that his financial testimony was based on the \$60 million valuation for the Pekin District calculated by Mr. Reilly. The City contends that since the rate increases presented by Mr. Ruckman are tied to an inflated valuation amount, the resulting projected rate increases are also inflated. [Pekin Ex. 8.0, p. 20.] The City asserts that there is no support behind any of IAWC's challenges to the rate freeze, and requests the Commission heed Staff's recommendation and find that the rate freeze is one benefit of City acquisition.

**(iv) Acquisition is possible while maintaining a strong bond rating**

The City explains that the purchase price of the system has only a limited relevance to this proceeding. The City notes that the Commission has recognized that it has no jurisdiction over the price to be paid in condemnation proceedings and that the Commission cannot predict an appropriate price "with any reasonable degree of accuracy." See County of Lake, p. 4. At the hearing, however, it was indicated that "the amount of indebtedness that the City may be forced to undertake is an issue that needs to be addressed as far as the public interest standard goes." [Tr., p. 845.] To that end, the City provided detailed evidence supporting RFC's estimation that a willing buyer and a willing seller would set the value of the Pekin District to be approximately \$14 million. [Pekin Ex. 5.0, p. 10.]

The City contends that RFC's valuation is significant because Staff's financial analyst concluded the City's debt burden would remain low and, thus, its bond rating would be appropriate, if the City pays \$14 million to acquire the system. [Staff Ex. 2.0, p. 14.] The City also notes that Staff's financial analyst testified that the City's credit strength is sufficient to acquire and operate the Pekin District without adverse financial consequences if the City's total debt-issuance remains below \$26 million. [Staff Ex. 4.0, pp. 9-10.] The City concludes that, while it is not this Commission's responsibility to determine the value of the system, evidence shows that the City could acquire the system at a cost that is 85% above RFC's professional valuation analysis and still fall within the realm of financial reasonableness established by Staff. Moreover, the City notes that, after reviewing S&P's use of its benchmarks for establishing ratings, Ms. Hals testified that the City has the flexibility to obtain S&P's approval while incurring debt at a much higher value than Staff's figure of \$26 million. [Pekin Ex. 17.0, pp. 25-26.] The City also notes that testimony at hearing shows that the City would not proceed with acquisition if the purchase price rises to a non-feasible level. [Tr., p. 210.]

**(v) The income approach**

The City contends that the value paid for property taken in an eminent domain proceeding must represent the fair market value – what a willing buyer would pay to a willing seller. See, e.g., 735 ILCS § 5/7-121. The City notes that IAWC’s valuation witness testified that:

Fair market value is defined as the price in cash at which an asset would change hands between a willing buyer and a willing seller, where the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties have reasonable knowledge of the relevant facts.

[IAWC Ex. 10, p. 8.]

The City explains that in determining what price a willing buyer and a willing seller would agree to for the Pekin District, RFC relied principally on the income approach, but assessed the value of the system under several different valuation methodologies. Ms. Hals “considered all three approaches, as we are required to do, and have decided that some of the approaches will not produce a value that is appropriate in this case because it is not a value that would be paid by a willing buyer.” [Tr., p. 451.] As Ms. Hals’ succinctly responded to IAWC’s assertions:

Instead of “ignoring” the Reproduction Cost New Less Depreciation (“RCNLD”) method as [IAWC] claims, I considered it and subsequently rejected it. The definition of fair market value requires the individual valuing the entity to consider it from both the willing buyer and willing seller perspective. To the extent a valuation method is not appropriate for either the willing buyer or the willing seller, then that valuation method can be excluded. A willing hypothetical private buyer would rarely, if ever, pay RCNLD for a regulated utility since it is highly unlikely it could include that full investment in rate base. Further, a municipality would never pay RCNLD because the resulting rate impact on customers would be significant. Therefore, whether the willing hypothetical buyer is either an investor-owned utility or a municipality, RCNLD would not be appropriate.

[Pekin Ex. 17.0, p. 6.] The City established that the income capitalization approach is the most appropriate in determining the fair market value of the system. [Pekin Ex. 5.0, p. 17.] The City further contends that the income approach is an established method to determine fair market value in Illinois. [Pekin Ex. 17.0, p. 9.]

According to the City, the appropriateness of using an income approach analysis when valuing a regulated industry like a water utility is supported by the fact that the allowed rate of return is regulated, unlike other industries where the rate of return is unknown and somewhat dependent on the capabilities of the buyer. [Pekin Ex. 5.0, pp. 17-18.] The City notes that in a regulated industry, a buyer knows with some level of certainty what its return on investment will be and that those future profits should be the primary driver of a decision to purchase a water utility. [Pekin Ex. 8.0, p. 8.] The City concludes that an income approach, like the one relied upon by RFC in this proceeding, represents “fair market value” because a buyer would unlikely recoup its investment if it paid higher than the income approach value and a rational, willing buyer would not pay a price that would prevent that buyer from recouping its initial investment.

Ultimately, the City asserts that IAWC’s protests regarding the appropriateness of the income approach lose all credibility by the acknowledgement of IAWC’s President that IAWC itself has used this same valuation methodology to establish a value for utilities it has purchased in transactions where it is the willing buyer. [Tr., pp. 757-758.]

The City further notes that RFC’s financial feasibility analysis also utilized the market approach as a reasonableness check in comparing the valuation amounts calculated by RFC and IAWC. [Pekin Ex. 8.0, pp. 4-6] As testified by Ms. Hals, “due to the subjective nature involved in comparing sales of water systems, in this case, a valuation analysis based upon the market approach should be used as a reasonableness check rather than the primary method for establishing value.” [Id., p. 4.] IAWC’s President acknowledged that IAWC has also previously utilized a similar type of market approach reasonableness check. [Tr., p. 759.] The City notes that RFC’s market approach reasonableness check resulted in valuation amounts between \$14 million and \$19 million, and emphasizes that this reasonableness check demonstrated values for the Pekin District that are much closer to RFC’s valuation than the inflated value suggested by Mr. Reilly under the RCNLD approach. [Pekin Ex. 8.0, pp. 5-6.]

In the process of using the market approach analysis as a reasonableness check, as is evident from both her surrebuttal testimony and her testimony at the hearing, Ms. Hals completed a market analysis comparison that examined: (1) number of customers; (2) date of utility transaction; (3) net utility plant; (4) revenues; (5) earnings before interests, taxes, depreciation, and amortization; and (6) earnings before interest and taxes. [Pekin Ex. 17, p.7; Tr. pp. 476, 519.] After this six-point comparability analysis, Ms. Hals properly concluded that an active market for the Pekin System does exist. Her reasonableness check reaffirmed her conclusion that IAWC’s RCNLD value far exceeds the price at which a willing buyer and seller would arrive for the Pekin System. [Id., pp. 481, 486.] Ms. Hals’ rebutted IAWC’s concern with her use of stock acquisitions in her market reasonableness analysis, by demonstrating that stock transactions are appropriate for a reasonableness check when the debt assumed by the purchaser is considered, as Ms. Hals did. [Pekin Ex. 8.0, p. 4.] The City asserts that the validity of Ms. Hals’ decision to not rely upon a RCNLD analysis is consistent with IAWC’s admitted practice of not performing a RCNLD analysis when considering the purchase of a water utility. [Tr., pp. 757, 889, 975].

Finally, the City points out that Ms. Hals did not equate the value of the Pekin District with the IAWC made-up term “Original Cost Rate Base (OCRB).” As explained by the City, in Ms. Hals’ Schedule B-2, rate base is calculated directly from IAWC exhibits for Docket #00-0340 and is \$11,529,436. [Pekin Ex. 5.2, Schedule B-2.] Ms. Hals’ calculation to establish the value under the income approach, however, is much more complex. First, Ms. Hals forecasts operating, depreciation, and tax expenses (Schedule B-1); future rate base calculations (Schedule B-2); and future capital improvements and depreciation accumulations (Schedule B-3). [*Id.*, Schedules B-1, B-2 and B-3.] The City notes that Ms. Hals then uses these factors to forecast the revenue requirements of a hypothetical investor-owned buyer and resulting rate increases and revenues (Schedule B-4). [*Id.*, Schedule B-4.] She uses the ensuing net income, less capital investments, to determine the income available for distribution in the future (Schedule B-5). [*Id.*, Schedule B-5.] This distributable income is discounted to today’s dollars to give a net present value for the Pekin District of \$13,969,251. This demonstrated that, not only is Ms. Hals’ valuation estimate different from the rate-base calculation, it is actually 21% higher.

**d. IAWC’s financial analysis is unsupported**

**(i) Analyses prepared to create the maximum compensation**

The City asserts that the only way Mr. Reilly, Ms. Kane, and Mr. Ruckman can support their claims that acquisition is not feasible is to create a valuation that is geometrically above what a willing buyer would or could pay. IAWC’s valuation, presented by Mr. Reilly and Mr. Riethmiller, is at the heart of Mr. Ruckman’s and Ms. Kane’s assertions of unreasonable rate increases. It ignores that a willing buyer would not pay a price that would prevent that buyer from recouping its initial investment. Even IAWC witness Gloriod acknowledged that his conclusions were premised on IAWC witness Reilly’s suggested acquisition cost of \$60 million. [Tr., pp. 753-754.]

The City points out that IAWC witness Ruckman also acknowledged that his rate analysis assumed the \$60 million valuation calculated by Mr. Reilly. [*Id.*, pp. 974-975.] IAWC witness Kane’s testimony is also based on Mr. Reilly’s suggested acquisition cost. [IAWC Ex. 7.0R, p. 5.] The City asserts that when Mr. Reilly’s \$60 million valuation is adjusted to a reasonable level, all IAWC’s challenges to the financial feasibility and public interest of City acquisition fall. The City maintains that Mr. Reilly’s \$60 million figure cannot stand under applicable legal standards or the inconsistency of his analysis.

The City argues that, consistent with Mr. Reilly’s advice that experts using the key deprivation appraisal (which includes eminent domain) “can provide the kind of informed advice and counsel that clients or employers need to receive the maximum compensation in a deprivation”, Mr. Reilly presented a valuation for the Pekin District that is more than four times above what a willing investor-owned utility or a publicly owned utility would be able to recoup. [Tr., p. 909.]

**(a) IAWC's inconsistency in assumptions**

The City emphasizes that Mr. Reilly's \$60 million valuation figure was based primarily on income and RCNLD valuations. With respect to Mr. Reilly's income approach analysis, the only way Mr. Reilly was able to maximize his asserted value was to hypothesize that the most likely buyer was a municipality that could set rates as high as it would like and yet enjoy the lowest possible expenditures. The City notes that Ms. Hals testified that "[j]ust because a municipality is not regulated does not mean that it will set rates at whatever levels it desires." [Pekin Ex. 17.0, p. 4.] In fact, based on RFC's extensive experience, publicly-owned utilities operate on a break-even basis. Mr. Reilly agreed, testifying that "most municipalities operate utilities on a break even basis." [IAWC Ex. 10R, p. 15.]

The City argues that Mr. Reilly's income analysis ignores the obvious need to use consistent data, which would require either the comparison of investor-owned revenues with investor-owned expenses, or municipal revenues with municipal expenses. As explained by Ms. Hals:

In essence, Mr. Reilly takes the revenues of an investor-owned utility, less the lower costs of a municipal utility to generate the greatest amount of cash flow. By then applying the municipality's lower cost of capital as a discount rate, he is able to invent an over-inflated value by picking and choosing the most helpful financial data from two different types of ownership.

[Pekin Ex. 8.0, p. 11.]

The City submits the bias of Mr. Reilly's analysis is exposed by his own admission that municipalities operate their utilities on a break even basis. [IAWC Ex. 10R, p. 15.] The City notes that Mr. Reilly argued that the most likely buyer of the Pekin District would be a municipal and/or governmentally-owned entity. [IAWC Ex. 10R, p. 11.] Despite this assertion, the City indicates that Mr. Reilly's income analysis is based on investor-owned revenues. [Pekin Ex. 17.0, p. 4.] If Mr. Reilly's objective was to represent a municipality as the most likely hypothetical buyer in his valuation analysis, then the City submits he should have used the most likely financial environment of that same type of most likely buyer. By his own admission the most likely financial environment is the "break even" or "non-profit" nature of municipalities. To the City, this inconsistency confirms Mr. Reilly's bias in this case.

**(b) IAWC contradicts its own valuation expert**

It is the City's position that the most telling argument against the credibility of IAWC's valuation lies within IAWC's own contradictory testimony. The City notes that IAWC states it is not feasible to purchase the Pekin District at a value of \$60 million, yet



continues to insist that is what a willing buyer would pay. On the one hand, IAWC suggests (through Mr. Reilly's valuation) that a willing buyer would pay \$60 million for the Pekin District. Yet, IAWC also argues (through Mr. Ruckman and Ms. Kane) that acquisition of the Pekin District for \$60 million is not feasible because it would result in a 106% rate increase. [IAWC Ex. 2.0, pp. 11-12; IAWC Ex. 2.1, pp. 3-4.] The City maintains that if acquisition at \$60 million is not feasible, it is not plausible to argue that a willing buyer would acquire the Pekin District at the IAWC valuation of \$60 million.

**(ii) Not a “special use” property; RCNLD is inappropriate.**

The City also asserts that IAWC's use of RCNLD to calculate its \$60 million figure is legally flawed. The City emphasizes that Illinois law requires property taken by eminent domain to be valued at fair cash value. The City notes that there is one very limited exception if the property is a “special use,” and that the Illinois' eminent domain statute that addresses condemnation valuations provides:

Except as to property designated as possessing a special use, the fair cash market value of property in a proceeding in eminent domain shall be the amount of money which a purchaser, willing but not obligated to buy the property, would pay to an owner willing but not obligated to sell in a voluntary sale, which amount of money shall be determined and ascertained as of the date of filing the complaint to condemn.

735 ILCS § 5/7-121. The City asserts that, while IAWC goes to great lengths to support its use of the RCNLD valuation methodology, the Pekin District is not a “special use” property.

According to the City, the Illinois Supreme Court has developed a long-standing and highly restricted special use doctrine that is applicable only in a “few exceptional cases in which market value cannot be the legal standard because the property is of such nature and applied to such special use that it cannot have a market value.” City of Chicago v. Farwell, 121 N.E. 795, 797 (Ill. 1918) (citations omitted). The City notes that Illinois courts interpreting this “special use” exception have held that the special use doctrine only applies when “the use of property may be so unique or special that it is not ordinarily bought or sold and that therefore no ‘market’ exists.” Department of Public Works and Buildings v. Huffeld, 215 N.E.2d 312, 316 (Ill. Ct. App. 1966), citing Farwell, 121 N.E. 795. The City also notes that Illinois courts have recognized that the “unique” concept within the special use doctrine admits “only a few structures, principally those having historic value, such as a Frank Lloyd Wright house, the Old Capital in Springfield, Holy Name Cathedral in Chicago or The Water Tower.” People v. Young Women's Christian Association of Springfield, 375 N.E.2d 159, 163 (Ill. Ct. App. 1978), *rev'd on other grounds*, 387 N.E.2d 305 (Ill. 1979).

The City recognizes that Mr. Reilly disputes that Illinois courts have defined a special use as “a use where there is no readily ascertainable market value.” [Tr., pp.

878-879]. Yet, the City explains that in Department of Transportation v. Mullen, 457 N.E.2d 1362 (Ill. Ct. App. 1983), the Illinois Court of Appeals explicitly noted that “property is classified as a special use only if it has no readily ascertainable market value, which is something quite different from its unsuitability for other uses.” Id. at 1367. The City also emphasizes that Mr. Reilly admitted at the hearing that he does not have any knowledge regarding, and did not consider, the types of properties that Illinois courts have determined not to be special use. [Tr., p. 889.] According to the City, the special use doctrine has generally been recognized to only apply to churches, colleges, cemeteries, clubhouses, and terminals of railroads. See, e.g., Farwell, 121 N.E. at 797 (citations omitted). The City maintains that a water system is not within the categories of properties previously recognized as special uses by Illinois courts.

The City notes IAWC’s contention that the Pekin District is a “special use” property because of its “limited” marketability, and responds by noting that is not the accepted “special use” standard in Illinois. As noted above, Illinois courts interpreting the special use doctrine have only applied it when “no market” exists. See, e.g., Huffeld, 68 Ill.App.2d at 128-129; see also Farwell, 286 Ill. at 420 (limiting the special use exception to properties that “cannot have a market value”).

The City suggests that the inappropriateness of Mr. Reilly’s RCNLD analysis is also highlighted by the fact that there is a demonstrated market for water utilities of various sizes across the United States. [Tr., p. 463.] The City asserts there have been at least 119 water utility transactions in Illinois alone since 1975. [Pekin Ex. 8.0, p. 1; Pekin Ex. 8.1.] The City also notes that AWWC and its subsidiaries have been involved in many water utility asset transactions. [Pekin Ex. 8.0, p. 3; Pekin Ex. 8.1.] For example, the City indicates that IAWC’s President testified about two transactions involving IAWC, and admitted both transactions involved willing buyers and willing sellers. [Tr., p. 757.] In addition, the City stresses that the Pekin District itself was purchased by IAWC in a private sale in 1982. [Tr., pp. 805-806.] The City also notes that, when asked about potential acquisitions of water systems, IAWC witness Mark Johnson responded that “We always have potential acquisitions on the horizon.” [Tr., p. 939.] According to the City, not only is there an ongoing market for water utilities, but IAWC is an active participant in that market. The City believes that this emphasizes that the Pekin District is not a “special use” property and that the use of an RCNLD analysis is inappropriate here. [Pekin Ex. 8.0, p. 1.]

In an attempt to support its use of RCNLD, IAWC looks to treatises and case law from other states. The City believes this is inappropriate as Illinois courts are clear and other cases have no precedential value in Illinois. In addition, IAWC’s reliance on Massachusetts-American Water Company is inappropriate because, in that case, the condemnor did not contest that the property in question was a special purpose property. See Massachusetts-American Water Co. v. Grafton Water District, 631 N.E.2d 59, 60 (Mass. Ct. App. 1994). The City also notes that the Moon Township case relied upon by IAWC does not involve the acquisition of a water utility for continued use by a municipality, but the condemnation for highway construction at a site uniquely suited for a potential water treatment plant. See Moon Township Municipal Authority Condemnation, 4 Pa. D. & C.3d 421, 421; 424 (Pa. Ct. Cmmn. Pls. 1978). The City

also notes that the Moon Township court stated that use of replacement cost valuation is only appropriate “where there is no other way to determine just compensation,” and evidence of replacement value “should not [be] received unless the circumstances were so peculiar as to render it absolutely essential, in the interest of justice, to require its admission.” Id. at 424-425 (citations omitted); see also, Township of Manchester Department of Utilities v. Even Ray Co., Inc., 716 A.2d 1188, 1195 (N.J. Super. Ct. App. Div. 1998) (stating that when comparable sales method of valuation is unavailable, replacement cost is appropriate when condemnation necessitates the provision of substitute sewer facilities; however, “If no substitute facility is necessary, fair market value will be the standard for compensation, when it can be ascertained.”)

The City also submits that IAWC misconstrues the holdings of the Illinois cases cited for the contention that replacement or reproduction is a favored valuation methodology. The City contends that the court in Chicago City Bank & Trust merely cited replacement cost as an example of an alternative valuation method that may be available in cases of a “special use” property. See Chicago City Bank & Trust Co. v. Ceres Terminals, Inc., 93 Ill.App.3d 623, 630 (Ill. Ct. App. 1981). The court in County of Cook allowed evidence of the cost of adjacent land to replace the school property that was taken because the school had a legal obligation to replace the condemned portion. See County of Cook v. City of Chicago, 84 Ill.App.2d 301, 309 (Ill. Ct. App. 1967). In this proceeding, the City notes that IAWC has no obligation to, and will not, replace the Pekin District if it is acquired by the City. Finally, the City submits that in City of Chicago v. George F. Harding Collection, neither the classification of property as “special use” nor the appropriate valuation method was actually at issue. See 70 Ill.App.2d 254, 257 (Ill. Ct. App. 1965). Both parties in that case conceded that the subject property, a museum, was a special use that would be valued at replacement cost or reproduction value to accommodate the relocation of the museum. See id.

**(iii) IAWC never relies on RCNLD when valuing a utility for purchase**

The City suggests that the ultimate shortcoming in the credibility of IAWC’s RCNLD valuation is confirmed by IAWC’s own testimony. Several IAWC witnesses acknowledged that IAWC does not perform RCNLD analyses to value a utility when IAWC is a willing buyer negotiating with a willing seller in utility acquisitions. [Tr., pp. 755, 757, 889, 975.] The City notes that IAWC’s discovery responses went even further, admitting that neither IAWC nor its parent company, AWWC, utilize the RCNLD appraisal methodology when determining the value of a water utility. [Pekin Ex. 8.0, p. 3.]

The City’s expert made clear why neither IAWC nor a municipality would use an RCNLD approach as a willing buyer:

A willing hypothetical private buyer would rarely, if ever, pay RCNLD for a regulated utility since it is highly unlikely it could include the full investment in rate base. Further, a

municipality would never pay RCNLD because the resulting rate impact on customers would be significant.

[Pekin Ex. 17.0, p. 6.]

As the record further demonstrated, Mr. Reithmiller's and Mr. Reilly's RCNLD valuation must be questioned:

Further, one must question the results of the RCNLD presented by Mr. Reilly when compared to the RCNLD analysis that was performed by Illinois-American in 1997 and updated in 1999 that estimated the value of RCNLD at between \$34 million and \$40 million (other values calculated in this study ranged between \$17 million and \$19 million) (Hals Surrebuttal Attachment 3). Although Illinois-American has tried to say that this was not an RCNLD analysis, Mr. Ruckman called it an RCNLD analysis, and it was labeled as an RCNLD analysis in the report itself. I would agree that the 1999 RCNLD analysis uses a different methodology than used to establish the value advocated by Mr. Reilly, but the 1999 RCNLD analysis points out the fact that it is not unreasonable that a different engineer may come up with a value much closer to \$34 million, and thus a totally different RCNLD analysis than relied upon by Mr. Reilly.

[Id., pp. 10-11.]

**e. City acquisition will provide local control, management and oversight**

The City contends that water is an important factor in any development decision. [Pekin Ex. 1.1, p. 2.] By controlling this important asset, the City believes IAWC has the ability to control development within the Pekin community without being accountable to the residents of that community. According to the City, acquisition of the Pekin District will shift accountability and control of this important resource to the local representatives of the community.

The City explains that the importance of local control and coordination was highlighted in the Water Task Force Report and the testimony in this proceeding. [Tr., p. 173.] For example, the Water Task Force noted historical problems with the coordination of utility work. [Id.; Pekin Ex. 1.1, pp. 2-3.] In addition, the City Manager described additional historical coordination problems involving "recently resurfaced roads within the City that were then dug up within weeks of the completed resurfacing, so that Illinois-American could do its own capital improvements on pipes." [Pekin Ex. 1.0, p. 13.] The City contends that, under City ownership, integrated planning for infrastructure, roads, sewers, and water will coexist, providing the City the flexibility to

plan and act without the inclusion of a not-always-cooperative IAWC. [Pekin Am Ex. 7.0, p. 11.] The City highlights that Staff recognized this integrated planning of infrastructure as one public interest advantage of City acquisition. [Staff Ex. 1.0, p. 12.]

The City maintains that City acquisition of the system would also give local leaders the benefit of being able to work and negotiate directly with developers on issues of continued growth and development. [Pekin Ex. 1.0, pp. 9-10; Pekin Am Ex. 7.0, p. 10; Pekin Am. Ex. 2.0, pp. 12-13.] The City suggests that there have been historical problems with IAWC in attempting to attract and work with developments around the City. [Pekin Ex. 1.0, pp. 9-10.] For example, the City points to the Water Task Force Report's notations of instances in which development was delayed or expenses increased for the City because of IAWC's disagreement with the developer or company. [Pekin Ex. 1.1, p. 2.] The City points out that this advantage of City acquisition was specifically referenced by Staff witness Johnson:

There are advantages to being able to negotiate with developers and large industrial customers from what may be termed a 'holistic' perspective. For example, a municipality could offer tax incentives, property incentives and utility service rates without the inclusion of a third party (i.e., public utility). It could also guarantee timelines to with the negotiations.

[Staff Ex. 1.0, p. 12.]

Former Pekin Mayor Tebben described the developmental benefits of municipal acquisition in his testimony:

It will be the City Council that can decide when and where improvements are made, without having to negotiate, wait, cajole, and attempt to coerce a distant corporate hierarchy to look out for Pekin's best interests and move at Pekin's pace. It will aid in the coordination of Pekin's comprehensive plan for community growth, especially economic development, as well as public works, street and sewer.

\* \* \*

In this area, we have been the victim of distant indifference to our conditions. That, I would have guaranteed you, would have changed with City ownership . . . .

[Pekin Am. Ex. 4.0, p. 5.]

As recognized by the City Manager, "even though the problem has improved somewhat, we have no assurance that it will remain at an acceptable level." [Pekin, Ex. 1.0, p. 13.] The risk that historical problems will return is eliminated if the accountability for, and control of, the system is shifted to the local representatives of the Pekin

community. Thus, the City contends that the public interest will be served by the local control, management and oversight made available through City acquisition.

**f. Extraterritorial customers will benefit from City acquisition**

The City contends that all the evidence presented in this proceeding shows that extraterritorial customers (i.e., people living within the Pekin District service territory but outside the City's limits) will continue to be treated just as they have been in the past, without discrimination. [Id., p. 12.] As summarized by the City Manager, extraterritorial customers "will pay the same rates and have the same access. In addition, problems and complaints will be handled in the same manner as those existing customers lying within the City." [Id.] The City asserts that IAWC was unable to present any evidence that extraterritorial customers will be discriminated against if the City is permitted to acquire the Pekin District.

The City asserts that the rate freeze included in the City Council's resolutions would apply to all current customers of the system, as recently reiterated by the current City Council. [Pekin Ex. 15.1.] According to the City, this commitment has never varied despite elections and turnover within City Council. [Pekin Ex. 15.0, p. 11.] According to the City, residency will not be an issue. [Tr., p. 209.] Importantly, the City points to Staff's testimony that it has no reason not to take the City at its word on this issue. [Id., pp. 75-76, 79-80.] In fact, the City notes that Staff witness Johnson specifically testified that there is nothing in the record that indicates or causes him to believe the City might or would discriminate against extraterritorial customers. [Id., p. 82-83.]

The City classifies IAWC's speculation that the City might condition water extensions for future developments upon annexation is insufficient to demonstrate discrimination. While IAWC relies on speculative annexation statements to support its argument, according to the City, the only evidence in the record indicates that all the annexations in recent history are voluntary ones, with developers wanting to come into the City for services. [Id., p. 213; Pekin Ex. 1.0, p. 11-12.]

The City asserts that it has a history of treating extraterritorial customers fairly. The City points to the fact that it has served similar extraterritorial customers through its wastewater system since 1975. [Tr., pp. 386-387.] According to the City, those extraterritorial customers have always received service at the same rates paid by City residents. The City notes that the bills for those extraterritorial customers are in fact lower than the City residents' bills because the City, through its intergovernmental agreement with the neighboring community, is not responsible for all of the services provided to the City residents. [Id., pp. 387-388.] As such, the City notes that the extraterritorial customers' bills are adjusted downward to take into consideration the equitable fact that the City was not asked to provide all of the services provided to City residents. [Id., p. 388.]

The City also maintains that just as there is no record support for IAWC's implication that the City will discriminate against extraterritorial customers, there is also no economic support for this contention. The City notes that extraterritorial customers

constitute less than 10% of the total Pekin District customer base. [Pekin Ex. 17.0, p. 15.] Thus, the City provided evidence that, “[b]ased on RFC’s rate setting experience, it would not be worth the City’s time or money to try to set a rate differential between outside and inside City customers to generate additional revenues since outside City customers constitute such a small portion of the customer base.” [Id., pp. 15-16.]

The City contends that the notion of possible unjust treatment of extraterritorial residents is also rebuffed by evidence that emphasizes that the extraterritorial customers of the Pekin District are not an isolated group without influence within the City. According to the City, the Pekin “community” includes the people inside and outside the City’s limits. [Pekin Am. Ex. 7.0, pp. 1-2.] The City notes that the extraterritorial areas within the system are often nearly surrounded by portions of the City and that these are not isolated “islands.” [Id., p. 2.] The City also contends that many of the persons living in the Pekin District’s service areas that are technically outside of the City’s limits are business owners in the City and have significant influence within the City. [Id., pp. 2-3.]

The City maintains that Fernway, which is relied upon by IAWC, is distinguishable. According to the City, the Commission noted in Fernway that the petitioning district consisted of 226 acres and included 338 water customers, while the extraterritorial area of concern contained 600 acres and 100 water customers. See Fernway, ICC Case No. 52024, at 2. The percentage of affected extraterritorial customers in Fernway was 22.8%, almost triple the percentage of extraterritorial customers in Pekin (8.8%). The City also points out that the Commission emphasized in Fernway that the Village constituted more than 70% of the area involved and had the most potential for growth in population. Id. at 8. The City stresses that neither of these facts is present in this case.

The City argues that extraterritorial customers will receive significant benefits from City acquisition. The City emphasizes that Staff recognizes several benefits of City acquisition that would apply to all customers of the Pekin District, irrespective of where the customer lives. The City notes the following advantages recognized by Staff: the income tax exemption, ability to pursue funding sources unavailable to private enterprise, no rate of return on capital, direct negotiations with developers and large industrial customers, integrated and flexible infrastructure planning, direct resolution of maintenance concerns, fire prioritization, and the proposed five-year rate freeze. [Staff Ex. 1.00, pp. 16-17; Tr., pp. 72-73, 75-76, 91-92.]

The City further argues that Staff witness Johnson’s concern about the lack of guarantee of protection against discrimination ignores protections under the common law available through judicial review. See, e.g., Inland Real Estate v. Village of Palatine, 107 Ill. App. 3d 279 (Ill. Ct. App. 1982). The court in Inland Real Estate was faced with a similar argument that review of rates by the Commission is required to protect the rights of certain consumers where those consumers did not have a vote because they were not residents of a municipality. In that case, the court noted:

We note, however, “that the inability of the consumer to vote municipal officials in or out of office does not leave the consumer without a remedy, because the reasonableness of their rates is subject to judicial review.” (*Conner v. City of Elmhurst* (1963), 28 Ill.2d 221, 190 N.E.2d 760; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235; *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App.3d 89, 40 Ill. Dec. 164, 405 N.E.2d 1256) As the Supreme Court elaborated in Springfield:

“Municipal officers under the Municipal Ownership act cannot discriminate in rates or make exorbitant and unjust rates to consumers if they discharge their duties faithfully, honestly and efficiently under the act. All their rates and charges fixed by ordinances or resolutions are subject to review by the courts to a like extent as the rates fixed by the Public Utilities Commission for public utilities privately owned, although the matter of review may be had under a different law and by a different remedy.” 292 Ill. 236, 253, 125 N.E. 739, 739, 746, *aff’d* (1921), 257 U.S. 66, 42 S. Ct. 24, 66 L.Ed. 131.

The Courts are in agreement that municipalities selling water to non-residents do so in their proprietary rather than their governmental capacity and, in so doing, are subject – as are privately owned utilities – to the rule that utility rates must not be unreasonable or discriminatory. (*Conner v. City of Elmhurst* (1963), 28 Ill.2d 221, 190 N.E.2d 760; *Amalgamated Trust and Saving Bank v. Village of Glenview* (1981), 98 Ill. App. 3d 254, 53 Ill. Dec. 426, 423 N.E.2d 1230; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235.) As stated in *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App. 3d 89, 94-95, 40 Ill. Dec. 164, 170, 405 N.E.2d 1256, 1262:

“When a municipal corporation owns and operates a water system for the purpose of selling water to consumers, it is acting in a business capacity and is generally to be treated as if it were a private utility company. (Citations) \* \* \* At common law, such as enterprise, because it had a monopoly on the service provided in the area, was prohibited from charging exorbitant rates and was required to serve all of its consumers without unreasonable discrimination in rates or manner of service. (Citations) Today, private utility



companies are prevented from charging exorbitant rates or from engaging in unreasonable discrimination in rates or manner of service by statute, and are no longer subject to the common law. (Citation.) Though there is no statute that prevents municipal corporations that operate public utilities from acting in an unreasonably discriminatory manner, there is still the common law duty that prevents them from doing so.”

107 Ill. App. 3d at 282-283.

The City further emphasizes that despite Staff witness Johnson’s guarantee concerns, he continued to endorse all other advantages of the Pekin District acquisition in his rebuttal testimony and in his testimony at the hearing. [Tr., pp. 91-92.]

**g. City acquisition will not impact the water rates of IAWC’s other rate areas**

The City asserts that acquisition by the City can be accomplished without having a negative impact on the water rates of IAWC’s other rate areas. As explained by the City, IAWC has a unified rate in Illinois, but has excluded the Pekin District from that unified rate because of the less expensive methods needed to supply water to the Pekin District customers. [Pekin Ex. 1.1, p. 3.] Ms. Hals testified that:

Since the Pekin District has its own stand-alone rate, the only costs that would impact other customers of Illinois-American would be the common costs of the entire system. Since Pekin’s operating revenues constitute only 3.40% based on its present rates (or 2.94% based on its proposed rates) as compared to the total Illinois-American operating revenues, the net impact on other customers should be immaterial.

[Pekin Ex. 17.0, pp. 20-21.]

**h. Environmental issues related to the City’s wastewater facility are outside the scope of this proceeding and are unsupported by the record**

The City asserts that the general purpose and duty of the Commission is to ensure that efficient and adequate utility service is provided to the general public at reasonable rates. See, e.g., Commonwealth Edison Co. v. Illinois Commerce Commission, 538 N.E.2d 213, 216 (Ill. Ct. App. 1989) (citations omitted). The City contends that the environmental issues relating to the wastewater system raised by IAWC are not within the particular expertise of the Commission. See, e.g., id. Instead, the City suggests that the Commission must evaluate the City’s proposed acquisition of

the Pekin District based on a public utility service context and cannot base its decision on an environmental impact context. See, e.g., id. at 219.

The City notes that the Illinois Court of Appeals reversed a Commission decision under Section 7-102 of the Public Utilities Act that relied upon environmental concerns when evaluating the public convenience of a proposed sale of utility assets. In Commonwealth Edison Co. the Court noted:

It is apparent from the record that the Commission attempted to determine whether the proposed sale would benefit the general public. However, the Commission did not examine the sale in a public utility service context, but, instead, in an environmental impact context. This was beyond its authority and was therefore improper.

[Id.]

Even if these matters were properly before the Commission, however, the City contends that IAWC's arguments are exaggerated. For example, the City notes that IAWC places significant emphasis on the alleged sanitary sewer overflow ("SSO"). The City maintains it has made numerous efforts to work with the Illinois Environmental Protection Agency ("IEPA") to investigate whether the alleged SSO exists. [Pekin Ex. 6.0, p. 5.] The City notes that IEPA and the City conducted joint visual inspections of the manholes. [Id.] The City states that the system was televised in the area of the suspected overflow. [Id.; Tr., p. 311.] The City also indicates that it conducted dye water testing. [Id., pp. 266-267.] Despite this testing, neither IEPA nor the City has confirmed that an SSO in fact exists. [Pekin Ex. 6.0, p. 5.] Furthermore, the City points to Mr. Kief's testimony, which illustrates that additional plugging, cleaning, and televising of the sewer system was scheduled to proceed. [Tr., p. 278; Pekin Ex. 6.0, p. 5.] The City further asserts that, given the testing that has occurred without any SSO being proven, there is no record support for IAWC to opine as to the extent or effect of any such SSO. [Pekin Ex. 12.0, p. 12.]

In further support of its position that the wastewater facility demonstrates the City's administrative capabilities, the City cites evidence that the City has undertaken, and continues to undertake, steps to address and improve the wastewater system. The City notes that it performed significant expansions and extensions to the wastewater system, adding at least five miles of trunk lines to the system and upgrading all the lift stations. [Pekin Am. Ex. 2.0, p. 10.] The City also explains that it purchased and installed generators at each lift station to assist in crisis management. [Id.] The City also notes that it completely replaced a bar screen facility to address concerns previously raised by IEPA. [Tr., p. 316.] In addition, the City emphasizes that over the last five to ten years, the City has spent millions of dollars to eliminate sewer back-up problems identified by IEPA. [Tr., pp. 264-265.]

Although IAWC critiques the scope of the testimony filed by the City's environmental expert, Dr. Adams, the City notes that Dr. Adams properly limited his review to "the process capability of running a wastewater treatment facility and translating that confidence level to a drinking water system." [Tr., p. 580.] As Dr. Adams testified, such a limitation was appropriate because "operations at the City's wastewater treatment plant No. 1 would be the most relevant to the City's ability to assume operations of the water supply because, from an operational perspective, that represents the type of processes and management that would most directly relate to a water system." [Pekin Ex. 12.0, p. 10.] Dr. Adams testified that the City has more than satisfactorily demonstrated its administrative abilities at the wastewater treatment facility.

Contrary to IAWC's implications, the City notes that "meeting the effluent and providing a clean water back to the Illinois River is [the City's] primary concern." [Tr., p. 294.] To that end, the City notes that it maintains constant lines of communication regarding the operation of the wastewater facility, including daily contact with the wastewater facility's operator and at least monthly contact with IEPA. [Id., p. 375.] If problems are identified, there is an open dialogue to explain or correct the situation.

The City concludes that the wastewater treatment facility has had only "the usual amount of compliance issues over the years," and submits that is simply a part of operating a wastewater treatment system. [Pekin Am. Ex. 2.0, p. 9; Tr., p. 260 ("We comply with the terms of [the NPDES] permit, but again, like probably most, if not all, systems we have had some excursions from the permitting").] The City notes that the wastewater facility infrastructure is typical of other river communities in the area, which also experience occasional excursions during severe storm events without the fault of the facilities or their administrators. [Id., pp. 306-307.] This is also supported by the Staff's testimony that the deficiencies raised with regard to the wastewater facility do not necessarily mean that the wastewater system is operated improperly, but instead that improvements are often necessary to meet IEPA regulations. [Staff Ex. 3.0, p. 4.]

#### **i. The Pekin District is not a complex system**

The Pekin district is supplied by ground water. IAWC's President testified that "river water treatment is typically more complex" as compared to ground water supply. [Tr., p. 750.] During cross examination, IAWC's President was asked to compare the Pekin District to several other systems in Illinois and testified that the Pekin District was "less complex" than all but one. [Id., pp. 750-751.] According to the City, the undisputed fact is the Pekin District is less complicated as compared to most systems because of the easy access to, and the high quality of, the water in the aquifer. [Id.] The City notes that the water is pumped from fairly shallow wells, and needs only minimal treatment before being delivered into the system for consumption. [Pekin Ex. 1.0, p. 3; Pekin Am. Ex. 2.0, p. 3.] As such, the City asserts that its assertion that the Pekin District is not complex is well supported.

**j. The City is best equipped to handle IAWC's projected "conditions in the water industry"**

The City argues that IAWC cannot support its continued ownership of the Pekin District based on "future challenges" facing the water industry. Even a cursory review of IAWC's assertions emphasize that the concerns raised by IAWC are national in scope and raise nothing specific to the Pekin District. More important, IAWC's alarmist arguments lose all credibility given the limited capital improvement forecasts presented by IAWC in this proceeding. [Pekin Ex. 8.0, pp. 16-19.] The City asserts that these limited capital improvement projections do not support the excessive infrastructure costs warned against by IAWC.

Even if the concerns in the report highlighted by IAWC turn out to be correct, however, the City asserts that it will best be able to address these needs. The future capital needs of the Pekin District can be met more cost effectively with City ownership since a municipality enjoys a lower cost of capital. [Pekin Ex. 8.0, p. 23.]

The City argues that it has demonstrated its ability to financially address any future "conditions in the water industry. The City worked with the IEPA to put together a groundwater protection ordinance for the wells used by IAWC to provide water to the Pekin District. This ordinance was reviewed by the IEPA, presented to City Council and adopted. (Pekin Am.Ex. 2.0, p. 4). Through this ordinance, the City controls development in the sensitive recharge and setback areas for the wells serving the Pekin District. (*Id.*, pp. 4-5) This groundwater protection plan has been acknowledged nationally and recognized as a Groundwater Guardian for eight consecutive years. (*Id.*, p. 4.; Pekin Ex. 6.0, p. 6.) The City asks the Commission to reject IAWC's assertion that "future challenges" facing the water industry support IAWC's continued ownership of the Pekin District.

**3. The City's plan to hire a reputable contract operator is well documented**

The City maintains there is ample evidence that it will hire a competent contract operator upon acquisition of the Pekin District, and suggests there is no record support for IAWC's challenges to this assertion. The City relies on the fact that several City witnesses testified that the City will hire a reputable contract operator to run the system once it is assured of acquisition of the Pekin District. [Pekin Am. Ex. 7.0, p. 5; Tr., pp. 383-384.] The City also notes Staff testimony that if the City contracts with a professional certified contractor (whether it be United Water, U.S. Filter or IAWC), as is the City's plan, City ownership could serve the public interest just as well as IAWC's continued ownership. [Tr., p. 77.]

The City maintains that it is premature for the City to select the actual contract operator that will run the system at this early stage of the condemnation proceedings. [Pekin Ex. 17.0, p. 19; Tr., pp. 194-195, 383-384.] The City notes that acquisition is still

several years away and any operator selected at this point in time may not be in existence when the acquisition eventually occurs due to the volatile nature of the water industry and the pace of corporate mergers and acquisitions, as evidenced by IAWC's recent history. Conversely, the City also maintains that there may be better operators available at that time that the City will not be able to consider if it is required to select an operator now.

Even the President of IAWC suggested that an RFP may be unnecessary at this stage of the condemnation proceeding. [*Id.*, p. 746.] To further support its position that it is premature to select an operator, the City points to the testimony filed by the City Manager:

As a practical matter, Illinois-American and its owners have delayed the Peoria acquisition by five years, even though they have a clear franchise obligation to sell. Given the amount of money, over \$1,500,000 spent to fight the referenda in Pekin, and the resources they are devoting to this proceeding, the City can expect an appeal of the decision from the I.C.C., as well as a long and arduous fight in Circuit Court in condemnation, with appeals from that. With that kind of delay, it is not prudent for the City to commit large amounts of time and money on plans that will certainly change over a period of years. Illinois-American openly admits that they change the plan each year, as does the City with our capital plan. Similarly foolish is their criticism of the City for not choosing a contract operator years before we have ownership, or at least ownership is certain within a definite time frame. The RFPs will be developed once it makes sense to develop them. The question isn't whether we have developed an RFP, but whether we have the expertise, experience and talent to do the job right. We do, as we have demonstrated.

[Pekin Ex. 15.0, p. 3.]

The City submits this will always be the case and that requiring a formal RFP prior to Commission approval will inevitably lead to requests such as this one being denied, thereby eviscerating the authority granted by the legislature.

The City notes that it can continue to enjoy all of the benefits, efficiencies, and expertise of a seasoned water operator by hiring a reputable contract operator. [Pekin Ex. 17.0, p. 25.] Both IAWC's President and Vice President of Engineering recognized that IAWC could be the contract operator for the System, and – if that were to happen – the full panoply of IAWC resources would still be available to Pekin District as a stand-alone system. [Tr., pp. 722-725; p. 970.] The City also points to Staff's witness Johnson's testimony, which recognizes that the City would "ensure that professional certified operators maintain the integrity of the system." [Staff Ex. 1.0, p. 9.]

#### **4. The City has the power to proceed with this condemnation**

The City maintains it has the legal authority to proceed with the condemnation of the Pekin District system. The City contends that IAWC's assertions to the contrary, which were first raised in its post-hearing briefing, are untimely and incorrect. The City believes it has both the general power to acquire property outside of its boundaries and, by legislative grant, the eminent domain power to acquire the Pekin District in its entirety.

The City notes that a municipality generally has the power to acquire property outside of its corporate limits. See, e.g., People ex rel. City of Salem v. McMackin, 53 Ill.2d 347, 365 (Ill. 1972). More specifically, the City maintains that Division 130 of the Municipal Code permits a municipality to purchase a waterworks system in its entirety. The City notes that Section 11-130-1 provides that "any municipality may purchase or construct waterworks or construct improvements to its waterworks as provided in this Division 130." 65 ILCS 5/11-130-1. Section 11-130-2 then defines the term "waterworks": "The term 'waterworks', as used in this Division 130, means and includes "a waterworks system in its entirety or any integral part thereof, including mains, hydrants, meters, valves, stand pipes, storage tanks, pumping tanks, intakes, wells, impounding reservoirs, or purification plants." 65 ILCS 5/11-130-2. Therefore, the City concludes that Division 130 provides a municipality with broad powers to acquire an entire waterworks system, such as the Pekin District.

The City also asserts that the legislature granted municipalities the right of eminent domain to exercise Division 130's broad acquisition powers. The City points the Commission to Section 11-130-9, which provides "For the purpose of purchasing any waterworks under this Division 130, or for the purpose of purchasing any property necessary therefor, the municipality has the right of eminent domain as provided by Article VII of the Code of Civil Procedure, as heretofore and hereafter amended." 65 ILCS 5/11-130-9. The City claims that it therefore has the power to use eminent domain to acquire an entire waterworks system (and any property necessary therefor), even if a part of that system may be outside of its corporate boundaries.

The City asserts that IAWC's attempted reliance on Division 117 to suggest the City lacks the requisite authority misses the point, and notes that Division 117 is inapposite. The City emphasizes that it has proceeded under Division 130 from the outset. [Petition, ¶ 3.] The City also suggests that IAWC's attempted reliance on only selected portions of Section 11-117-4 of Division 117 is misplaced. By omitting the bulk of this section, the City contends that IAWC cites it in a very misleading way. When read in its entirety, the City submits that Section 11-117-4 is far different than anything found in Division 130. Further, the City again emphasizes that it does not rely on Division 117 in this proceeding, but rather relies on Section 11-130-9, which authorizes a broader right allowing a municipality to condemn an entire waterworks system.

The City rejects IAWC's implication that the Commission's decision in Fernway Sanitary District v. Citizens Utility Company of Illinois, July 10, 1968 Order, Case No. 52024 (ICC 1968), somehow supports IAWC's contention that the City lacks the authority to condemn property outside of its boundaries. The City maintains that this implication is not supported by the Commission's actual Order in Fernway. First, the City declares that Fernway, like Division 117 and the City's home rule powers, has nothing to do with the eminent domain powers granted in Division 130. Second, the City notes that the Commission specifically recognized that the relevant statute in Fernway gave the petitioner the right to condemn property "either within or without its corporate limits" if consistent with the corporate purposes established upon creation of the Fernway District. See id., p. 5. The City argues that the Commission's holding in Fernway was based entirely on the petitioner's self-limiting corporate charter, which restricted the petitioner to supplying services exclusively to the citizens located within its boundaries. See id. The City emphasizes that no such relevant restrictions exist here.

The City asserts that the only authority IAWC cites relating directly to Division 130 is Village of Bolingbrook v. Citizens Utility Co., 267 Ill. App.3d 358 (Ill. Ct. App. 1994). According to the City, IAWC attempts to rely on this case as construing Division 130 strictly against a municipality seeking to condemn a waterworks. However, the City notes that in Village of Bolingbrook, the issue being "strictly construed" was not whether extraterritorial property could be acquired by a municipality, but rather whether the municipality could proceed with an eminent domain action without first receiving Commission approval. The City emphasizes that the court specifically stated, "Since we find that the issue of ICC approval is determinative of the outcome of this case, we will confine our discussion to that issue alone." Id. at 359.

Finally, the City argues that "[a] primary rule of statutory construction is that a court must give the language of the statute its plain and ordinary meaning." Id. (citation omitted). Division 130 grants the authority to use eminent domain to acquire "a waterworks system in its entirety." See 65 ILCS 5/11-130-2; 5/11-130-9. Any argument to the contrary ignores the plain and ordinary meaning of Division 130. The City submits that IAWC's proposed interpretation would read the right of eminent domain completely out of Division 130, despite the legislature's specific grant in 65 ILCS 5/11-130-9, except in the rare instance where a municipality shares the identical geographic footprint of a waterworks company. As such, the City contends that IAWC's assertions that the City lacks the necessary authority to proceed with this condemnation are untimely, unsupported and against the plain and ordinary meaning of Division 130.

## **EXCEPTION TWO: STAFF POSITION**

Petitioner City of Pekin takes exception to the portion of page 37 of the Proposed Order that is entitled "Staff Position." Pekin suggests that the "Staff's Position" at page 37 of the Proposed Order be deleted in its entirety and replaced by the following language for the reasons set forth in its Brief on Exceptions:

## **B. Staff Position:**

### **1. Legal Standard**

Staff disagrees with IAWC witness Stack's "better or greater" public interest interpretation, and recommends that the Commission disregard it entirely.

Staff notes that the present proceeding is governed by Code of Civil Procedure Section 7-102. Staff disagrees with IAWC's proposed "better or greater" public interest standard as it ignores the only Illinois judicial opinion clarifying this relevant statutory standard. In Department of Conservation v. Chicago & North Western Transportation Co., the Illinois appellate court states "The basic function of the requirement found in [Code of Civil Procedure Section 7-102], requiring Commission approval before eminent domain proceedings may be instituted against utility property, is to insure that property necessary for utility purposes is not taken." 59 Ill. App.3d 89, 91 (1978). Recognizing the longstanding principle that the Commission "is not a judicial body, and its orders are not *res judicata*" (Mississippi River Fuel Corporation v. Illinois Commerce Commission, 1 Ill.2d 509, 513 (1953)) and respecting the Department of Conservation Court's focused clarification, Staff strongly encouraged the Commission to reconsider Fernway Sanitary District's extrastatutory requirements and speculative legislative intent.

Staff contends that the City's petition is properly evaluated on its own merits, not as a competing alternative, and recommends this approach to the Commission.

### **2. Public Interest**

Staff asks that the Commission adopt Staff witness Johnson's public interest determinations. Staff notes that Mr. Johnson conducted an independent and impartial public interest investigation. In Mr. Johnson's direct testimony, he testified that customers gain certain advantages under City ownership. These advantages include:

1. The City's income tax exemption;
2. The City's ability to pursue funding sources unavailable to private enterprises;
3. The absence of a rate of return on capital improvements;
4. The ability and control to directly negotiate Pekin District concerns with developers and large industrial customers;
5. Integrated and flexible infrastructure planning;
6. Direct resolution of Pekin District maintenance concerns;
7. City fire department prioritization of main replacements;
8. Citizen support demonstrated by recent referendum;
9. City commitments to non-discriminatory treatment of customers outside Pekin's boundaries;
10. A proposed five-year rate freeze; and
11. The ability of most customers to maintain oversight of Pekin District operations through the accountability of elected officials.



[Staff Ex. 1.0, pp. 16-17.]

In rebuttal testimony, Mr. Johnson reconsidered his direct testimony position regarding one issue related to the public interest of City acquisition. According to Staff, Mr. Johnson is no longer certain that the City's non-discrimination commitment guarantees the protection of Pekin District customers beyond City boundaries. [Staff Ex. 3.0, p. 6.] According to Staff, the Commission is without a mechanism to protect these customers once the Pekin District acquisition is complete because the water system would no longer be subject to Commission supervision. [*Id.*, p. 4.]

While Staff witness Johnson continues to endorse all other public interest advantages of City acquisition identified in his direct testimony [Tr., pp. 91-92], Staff notes that Mr. Johnson believes this "guarantee" concern outweighs all other advantages of acquisition foreseen in his direct testimony. For this reason alone, Staff notes that Mr. Johnson no longer believes City acquisition serves the public interest. [Staff Ex. 3.0, p. 6.]

Mr. Johnson's recommendation notwithstanding, Staff accords substantial deference to the 2002 City referendum showing 4,188 of 6,839 voting Pekin residents, or 61%, favoring City water acquisition. [Staff Ex. 1.0, p. 14.] Staff emphasizes that Pekin's residents and elected representatives provide a firsthand statement of the solution they feel best serves the collective public interest (and, by extension, whom they consider the better system operator). The Staff concludes that, although Staff and the Commission have a responsibility to nonvoting water system customers beyond Pekin's boundaries, this responsibility does not create an unlimited Commission mandate to second guess the City's legitimate expression of its civic interest.

### **3. Financial Condition**

Staff explains that Staff witness Phipps presented an analysis of the City's financial ability to acquire and operate the Pekin District. [Staff Ex. 2.0; Staff Ex. 4.0.] Staff emphasizes that Ms. Phipps did not estimate the Pekin District's value or purchase price, as Illinois law assigns this responsibility to the trier of fact in the subsequent eminent-domain proceeding, not to the Commission. The Staff contends that the Commission properly acknowledged this limited role in *County of Lake*:

The Commission has no jurisdiction over the price to be paid in condemnation proceedings[...]. We have no means of knowing how a jury would determine this point. We do not even know that, in a condemnation case, the evidence would be the same as that presented to us. Any finding which we might make on this subject would be meaningless[.]

Staff further explains that Staff witness Phipps analyzed the City's implied credit capacity and resulting financial condition using the estimates of Pekin District value

offered by the City and IAWC. [Tr., p. 132.] Specifically, Staff notes that City witness Hals assessed the Pekin District value using several different valuation methodologies, but ultimately selected the income capitalization approach. The Staff points out that, using this approach, Ms. Hals estimates the Pekin District value is approximately \$14 million. Staff also notes that IAWC witness Reilly estimates the Pekin District value at not less than \$60.3 million, using an RCNLD approach. Staff emphasizes that Ms. Phipps' use of these estimates in no way implies Staff endorsement of, or disagreement with, either of them.

Staff notes that Ms. Phipps evaluated Pekin's implied credit strength using the benchmarks published by Standard & Poor's ("S&P") for estimating a GO Bond Issuer's credit strength. [Staff Ex. 2.0, p. 5.] Staff notes that S&P assesses a municipality's capacity and willingness to repay GO Bonds using criteria relating to economy, financial performance and flexibility, administration, and debt burden. According to Staff, these S&P benchmarks provide objective standards for measuring the City's economic and financial strength as well as its debt capacity. [Id.]

With regard to the S&P benchmarks that are independent of the ultimate Pekin District purchase price, Staff notes that Ms. Phipps testified that the City's economic ratios suggest that the City's economic strength is average. [Id., p. 7.] Staff witness Phipps further testified that the City's financial ratios suggest a high level of financial strength and flexibility. [Id., p. 9.] While Staff notes that there are no S&P benchmarks for measuring a GO Bond issuer's administrative strength, Staff believes the City's implied financial condition is enhanced given its incorporation of the capital improvement program into the City's valuation and economic feasibility analysis. [Id., pp. 15-16.]

Staff notes that the fourth S&P benchmark, debt analysis, measures debt capacity using four ratios: (1) debt to market value; (2) carrying charge; (3) overall debt per capita; and (4) debt to income. [Id., p. 11.] Staff witness Phipps testified that the City's current debt ratios suggest that the City has a low debt burden, indicating high debt capacity. [Id., p. 12.] However, Staff notes that, because the City intends to finance its acquisition using GO Bonds, the purchase price of the Pekin District will directly affect the City's debt ratios. [Staff Ex. 4.0, p. 5.]

Staff believes that the City's debt burden will remain low if the City pays \$14 million to acquire the Pekin District. [Staff Ex. 2.0, p. 14.] Specifically, Staff notes that at a \$14 million purchase price, all four of Pekin's pro-forma debt ratios remain at the low end of the S&P benchmark ranges. [Id.] Using the same assumptions and ratio calculations, Staff witness Phipps concluded that City debt issuance exceeding \$26 million might adversely impact the City's financial strength and flexibility. [Staff Ex. 4.0, p. 9.] Ms. Phipps testified that at \$27 million, two of the four debt capacity benchmark ratios would exceed the midpoint of the moderate ranges for the benchmark thresholds. [Staff Ex. 2.0, p. 14.] Staff also notes that Ms. Phipps concluded the City's debt burden would adversely affect the City's financial condition if the City purchases the Pekin District by issuing \$60.3 million in debt. [Staff Ex. 4.0, p. 8.] Specifically, Staff notes

that at a \$60.3 million purchase price, all but one of the City's pro-forma debt ratios rise above the S&P benchmark thresholds for high debt burden.

Overall, Staff explains that the City's implied credit strength is sufficient to acquire and operate the Pekin District without adverse financial consequences provided the purchase does not require the issuance of GO Bonds in excess of \$26 million. [Staff Ex. 4.0, pp. 9-10; Schedule 4.01.] Staff concludes by noting, assuming a purchase price below the \$26 million total debt-issuance threshold identified by Staff witness Phipps, Staff is of the opinion that the City has the financial ability to acquire and operate the Pekin District. Staff further concludes that if the purchase price rises to a level causing adverse financial consequences, Staff expects that the City will not proceed with the acquisition.

#### **4. Speculative Service Issues**

Staff acknowledges the "voluminous testimony and myriad speculative arguments on which entity is best positioned to serve the Pekin District's customers." However, Staff notes it "is understandably reluctant to abandon its narrow, objective responsibility of evaluating the merits of Pekin's petition in favor of unnecessarily arbitrating subjective guesses on relative future behavior." Staff summarizes that it is poorly positioned to judge which arguments better predict future operating performance. Staff points to the conflicting wastewater accounts as an example of the many battles in which Pekin and IAWC needlessly invite Staff and the Commission to make "who's better?" determinations. According to Staff, these judgments are entirely unnecessary. Staff reiterates its reluctance to enter the fray and suggests the Commission approach this highly speculative debate with similar caution.

#### **5. Final Recommendation**

Staff ultimately recommends the Commission reject the City's petition to institute eminent domain proceedings against IAWC, "but only because customers living outside of Pekin's boundaries do not benefit from the service obligations and nondiscrimination provisions the Public Utilities Act provides IAWC customers."

### **EXCEPTION THREE: ROLE OF THE COMMISSION IN CONDEMNATION MATTERS**

Petitioner City of Pekin takes exception to the portions of pages 3 to 5 of the Proposed Order that are entitled "Role of the Commission in Condemnation Matters." Pekin suggests the "Role of the Commission in Condemnation Matters" at pages 3 to 5 of the Proposed Order be deleted in its entirety and replaced by the following language for the reasons stated in Pekin's Brief on Exceptions:

### C. Role of the Commission in Condemnation Matters

The Illinois Supreme Court held in Illinois Cities Water co. v. Mt. Vernon, 11 Ill.2d 547, 556 (1957) that supplying water to a municipality is a public purpose and that the municipality has the unquestioned power to acquire water utility property through eminent domain as long as all other legal requirements are satisfied. The Illinois General Assembly subsequently amended Section 7-102 of the Eminent Domain Act (“EDA”), 753 ILCS 5/7-102, to require that, except in circumstances not relevant here, approval of the Commission is required before assets of a regulated public utility can be condemned. Section 7-102 provides:

No property ... belonging to a railroad or other public utility  
subject to the jurisdiction of the Illinois Commerce  
Commission may be taken or damaged ... without the prior  
approval of the Illinois Commerce Commission.

The Commission thus has authority to determine whether Pekin’s Petition to condemn the Illinois-American assets comprising the Pekin District should be approved or denied.

In Lake County v. Lake County Water Corp., Docket No. 51032 (1966), the Commission noted that the amendment to Section 7-102 recognized the “general principle of law” that public ownership of a water utility represents a “larger and more general public benefit” than private ownership. (Id., at 5.) It also noted a limited exception to this rule, citing the example of a county’s attempt to condemn a utility that provides services to “half the people of the State.” (Id.) The Commission concluded two years later that Section 7-102 of the EDA authorizes it “to determine whether the public interest will better be served by granting or withholding approval ... to proceed in an eminent domain action.” Fernway Sanitary District v. Citizens Utility Company of Illinois, Docket 52024 (1968), at 3.

There is no express statutory authority for the Commission’s use of a public interest analysis in Fernway Sanitary District. Section 7-102 does not condition approval of a condemnation proceeding upon “the public interest” or “the public convenience.” See Illinois Power co. v. Illinois Commerce Commission, 111 Ill.2d 505, 512 (1986), applying the public interest standard to proceedings under Section 7-204 of the Public Utilities Act, which, unlike Section 7-102 of the EDA, explicitly includes a public interest requirement. Acts and orders of the Commission that exceed the statutory limits of its authority are void. Illinois Power Co. v. ICC, 111 Ill.2d 505, 510 (1986).

Lake County, supra, and Fernway Sanitary District, supra, are not binding precedent in the instant proceedings. The Commission agrees with the Court in Department of Conservation v. Chicago & North Western Transportation Co., 59 Ill. App.3d 89, 91 (1978), that “[t]he basic function of [Section 7-102] ... requiring Commission approval before eminent domain proceedings may be instituted against utility property, is to insure that property necessary for utility purposes is not taken.”

The Commission's present inquiry is thus limited to the question of whether the property necessary for utility purposes will be intact after Pekin's exercise of its power of eminent domain over the assets of Pekin District. The Commission finds that the utility will have all necessary property to provide water services after acquisition. Pekin is not required to prove that condemnation would "better serve" the public interest than continued ownership by Illinois-American, that Illinois-American has failed in its public duties, or that Illinois-American is otherwise at fault.

#### **EXCEPTION FOUR: PUBLIC INTEREST ANALYSIS**

Petitioner City of Pekin takes exception to the portions of pages 39-41 of the Proposed Order that are entitled "Public Interest Analysis." Pekin suggests the "Public Interest Analysis" at pages 39-41 of the Proposed Order be deleted in its entirety and replaced by the following language for the reasons set forth in its Brief on Exceptions:

##### **D. Standard of Proof**

The City bears the burden of demonstrating that the property necessary for IAWC's utility purposes will be intact after acquisition. The Commission finds that Pekin met that standard of proof. The Pekin District is served by seven ground water wells, while other water districts served by IAWC are served with surface water. For this reason, IAWC has always treated the Pekin District as a stand alone utility. Because Pekin seeks authorization to condemn all assets of Pekin District, IAWC, the utility regulated by the Commission, will remain intact after acquisition and all property necessary for utility purposes will be unaffected by the City's acquisition. Accordingly, the Commission finds that Pekin's planned acquisition should be approved pursuant to Section 7-102 of the EDA.

Section 7-102 does not contain a public interest standard, and the Commission concludes that it would be improper to evaluate whether municipal acquisition or continued ownership by the regulated utility would better serve the public interest. Nevertheless, the Commission also finds that Pekin's planned acquisition is in the public interest. The Illinois Supreme Court acknowledged almost 50 years ago that public ownership of a water utility represents a "larger and more public benefit" than private ownership. Illinois Cities Water Co. v. Mt. Vernon, 11 Ill2d. 547, 554-55 (1957). The Commission applied that rule in Lake County, supra, when it found that the amendment to Section 7-102 recognized a "general principle of law" that public ownership represents a larger public benefit. The Lake County ruling also noted a limited exception to that legal rule, explaining that a utility that furnishes services "to half the people of the State might well represent a 'larger and more general public benefit' than the interest of the county" in which it is located. (Id., at 5.) The same rule and the same limited exception were noted by the Commission again in Fernway Sanitary District, supra, at 7-8.

The Commission finds that the general principle applies and that condemnation will better serve the public interest than continued private ownership of the Pekin District assets. The limited exception to the general rule does not apply because only a small percentage of the Pekin District customers live outside the City's municipal boundaries, and they will continue to be served by the City after acquisition.

Illinois law has long recognized that municipal acquisition and control of municipal water services serves the public interest. The Pekin voters confirmed that public interest when they overwhelmingly approved the acquisition of the Pekin District in a referendum election. The evidence of record confirms that condemnation would serve the public interest in many ways. First, it is in the public interest to allow the public to control planning and coordination of community development. Pekin would have the ability to direct community growth in accordance with its own needs by negotiating tax incentives, property incentives, and utility service rates with developers and large industrial customers. The evidence shows that IAWC has sometimes delayed the extension of water service for prospective developments that would bring more housing and more jobs to Pekin. The issue is not whether IAWC or Pekin was correct in these instances, but rather whether it is in the public interest to permit the City to make development decisions in accordance with its own plans and preferences. The Commission finds that it is.

It is also in the public interest to utilize the many financial advantages that are inherent in municipal ownership. It is undisputed that municipal ownership would exempt the utility from income taxes and would enable it to obtain capital from more sources and at a lower cost than privately owned utilities. There is no evidence that the claimed (but unquantified) economic benefits of private ownership, such as obtaining services from corporate affiliates and receiving concomitant economies of scale, outweigh those savings. The Commission finds that a freeze or reduction in water service rates is financially feasible depending upon the price Pekin ultimately pays for the utility. It is both unwise and unnecessary to attempt any valuation of the property for purposes of the present proceeding. The evidence shows that the City will not agree to pay a financially infeasible price to acquire the utility.

Both IAWC and the City presented evidence of the need for capital improvements in the water system. The Commission finds that many of the older mains are too small and must be replaced. The Commission finds that municipal acquisition serves the public interest because it allows Pekin to prioritize and accomplish necessary improvements in the water mains in accordance with community service and safety needs, without regard to the private interests that must necessarily be considered by a privately owned utility. It is unnecessary to determine whether fire services would improve under municipal ownership. It is sufficient that the public has an interest in structuring capital improvements in accordance with its own priorities, including fire protection and community development.

Pekin introduced evidence about it owns the local wastewater facility in order to demonstrate that it has the administrative experience and expertise to administer the

Pekin District utility and select a qualified operator. IAWC introduced evidence that the IEPA is concerned about sewage contamination from a possible leak in the sewer system that neither Pekin nor the IEPA has been able to locate. The Commission does not have the legal authority or particular expertise to determine the existence or severity of a possible environmental problem. The Commission does find, however, that there is no evidence in this proceeding from which the Commission can conclude that the alleged leak actually exists or that it is the result of administrative inadequacy on the part of Pekin.

The Commission concludes that Pekin's acquisition of the Pekin District assets is in the public interest. Accordingly, the Commission would approve Pekin's Petition even if public interest analysis applied to Section 7-102 proceedings.

### **EXCEPTION FIVE: FINDINGS AND ORDERING PARAGRAPHS**

Petitioner City of Pekin takes exception to the portions of pages 41 and 42 of the Proposed Order that re entitled "Findings and Ordering Paragraphs." Pekin suggests that the "Findings and Ordering Paragraphs" at pages 41 and 42 of the Proposed Order be deleted in its entirety and replaced by the following language, for the reasons set forth in its Brief on Exceptions:

#### **E. Findings and Ordering Paragraphs**

Having considered the entire record herein and being fully advised in the premises, the Commission is of the opinion and finds the following:

- (1) Illinois-American is engaged in the business of providing water and/or sanitary sewer services to the public in the State of Illinois and, as such, is a public utility within the meaning of Section 3-105 of the Illinois Public Utilities Act;
- (2) the City of Pekin is a municipality within the meaning of the Illinois Municipal Code, 65 ILCS 5/1-2;
- (3) the Commission has jurisdiction over Illinois-American and the subject matter of this proceeding, in which the City seeks authority pursuant to 735 ILCS 5/7-102 to condemn the assets of Illinois-American that comprise Pekin District;
- (4) the recitals of fact set forth in the "Commission Conclusion" (Section V above) are supported by the evidence of record and are hereby adopted as findings of fact;
- (5) for the reasons discussed in the "Commission Conclusion," the City's Petition should be granted; and

- (6) any motions or objections or petitions in this proceeding that have not been specifically ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS THEREFORE ORDERED that the Petition filed by the City of Pekin is granted.

IT IS FURTHER ORDERED that any motions, objections, or petitions in this proceeding that have not been specifically ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Illinois Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review Law.

### **CONCLUSION**

Petitioner City of Pekin respectfully submits these five exceptions and requests that they be incorporated in the Proposed Order.

Respectfully Submitted,

Dated: November 17, 2003.

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**CERTIFICATE OF SERVICE**

Edward D. McNamara, Jr., an attorney, hereby certifies that he served copies of the foregoing Exceptions of Petitioner City of Pekin on the individuals shown on the attached Service List, via electronic mail, on Monday, November 17, 2003.

//Edward D. McNamara, Jr.//  
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